a Notice of Proposed Rulemaking to investigate ways to increase telephone subscribership nationwide.[45] As the Commission has thereby recognized, all aspects of this issue should be examined and addressed in a comprehensive, industry-wide rulemaking, rather than in a proceeding relating to one aspect of one carrier's operations.

CONCLUSION

As shown above and in AT&T's Comments, the evidence conclusively demonstrates that the interexchange market is fully competitive and that continued price cap regulation of Basket 1 services is no longer necessary or appropriate. The Commission should not adopt the rules proposed in the Further Notice, or the even more onerous, anticonsumer rules proposed

[45] See Amendment of the Commission's Rules and Policies to Increase Subscribership and Usage of the Public Switched Network, CC Docket No. 95-115, Notice of Proposed Rulemaking, FCC 95-281, released July 20, 1995.

by other commenters here, but should render a prompt decision in the Reclassification Proceeding, which should render this docket moot.

Respectfully submitted,

AT&T CORP.

By ______________________

Mark C. Rosenblum
Peter H. Jacoby
Mart Vaarsi
Clifford K. Williams

Room 3244J1
295 North Maple Avenue
Basking Ridge, New Jersey 07920
(908) 221-3539

Peter D. Keisler

1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 736-8000

Its Attorneys

July 24, 1995

ATTACHMENT 1

Parties Filing Comments

Name	Abbreviation
AT&T Corp.	AT&T
MCI Telecommunications Corporation	MCI
The Bell Atlantic Telephone Companies	Bell Atlantic
BellSouth Telecommunications, Inc.	BellSouth
Pacific Bell and Nevada Bell	PacBell
Southwestern Bell Telephone Company	SWB
Telecommunications Resellers Association	TRA
United States Telephone Association	USTA
The Competitive Telecommunications Association	CompTel

Attachment 2

STRATEGIC
POLICY
RESEARCH

7300 OLD GEORGETOWN ROAD SUITE 810 BETHESDA, MARYLAND 20814 (301) 718-0111 (301) 215-4033 FAX

DISABILITIES OF CONTINUED ASYMMETRIC REGULATION OF AT&T

JOHN HARING
JEFFREY H. ROHLFS
HARRY M. SHOOSHAN III*

Prepared for AT&T

June 30, 1995

* John Haring, Jeffrey H. Rohlfs and Harry M. Shooshan III are principals in Strategic Policy Research, Inc., an economics and telecommunications policy consulting firm located in Bethesda, Maryland. Dr. Haring formerly served as Chief Economist and Chief, Office of Plans and Policy, at the Federal Communications Commission. Dr. Rohlfs was formerly Department Head of Economic Modeling Research at Bell Labs. Mr. Shooshan formerly served as Chief Counsel and Staff Director for what is now the Subcommittee on Telecommunications, U.S. House of Representatives.

Introduction

Notwithstanding the comments of many interested parties with their own individual axes to grind, the critical analytical issue posed in this proceeding is a narrow one, and the relevant record evidence on this issue is clear and uncontroverted. The critical issue to be resolved is simply whether AT&T has the power to determine the market prices of various long-distance services. The relevant evidence is that AT&T's competitors clearly possess a very substantial supply capability relative to the size of the market (and AT&T's current share of it) and, therefore, that as a matter of elementary economics AT&T does not possess unilateral control over market prices. This in turn implies that AT&T is not a dominant firm in economic terms, and that asymmetrical regulatory burdens on AT&T cannot be justified on grounds of economic dominance.

The normative economic rationale for government regulation of industry is generally grounded in the existence of perceived market failures or imperfections (viz., monopoly, externalities, public goods) and the judgment that net benefits of regulation to remedy such failures exceed costs of regulatory intervention. While regulation may be capable of producing beneficial effects, it often simultaneously produces adverse consequences and is always costly (i.e., entails utilization of scarce resources capable of producing other valuable sources of consumer utility that must be foregone). This economic burden of regulation, consisting of adverse consequences (affecting the calculation of net benefits) and direct costs (entailing foregone benefits), assumes special significance in an environment where any putative benefits of regulation are difficult to discern. In such an environment, regulation becomes a cause of economic inefficiency rather than a tonic for economic efficiency.

In this submission, we focus on the adverse consequences of continued asymmetric regulation of AT&T in the long-distance market. In our view, the FCC's asymmetric regulation of AT&T has three significant negative impacts: (1) it inhibits AT&T's ability to compete and affords AT&T's rivals opportunities to exploit the Commission's administrative processes to thwart new pricing and service initiatives and to gain artificial competitive advantage; (2) bad regulation gives good regulation a bad name and, thereby, undermines the integrity of and public support for the legitimate institutions and processes of government; and (3) continued asymmetric regulation sustains incentives incompatible with the general lessening of regulation that is warranted by the evolution of competition in this market. As long as competitors can benefit from exploitation of asymmetric treatment, they have little incentive to support genuinely procompetitive deregulation. Under symmetric regulation, we would anticipate more rapid progress toward the achievement of genuinely procompetitive (de)regulatory reform.

Our comments are organized as follows: We begin by critically evaluating the evidence in this proceeding bearing on the question of AT&T's alleged market dominance. Opponents of reform cite AT&T's market share and its ability to raise its own basic rates as evidence of AT&T's dominance. Proponents of reform cite the ability of AT&T's competitors to expand supply significantly in short order, and even more substantially within a modest time frame, as inconsistent with market dominance by AT&T. They also cite customers' revealed willingness to switch carriers as inconsistent with the ability profitably to restrict output in the market. As noted initially, our view is that the latter argument prevails over any claim that market share connotes or denotes dominance.

We then turn to the disabilities and harms of the current asymmetric regulatory regime. We first consider marketplace harms, that is, harms to competition and the competitive process and, hence, consumers. There have clearly been instances where the current system of asymmetric controls has, either directly or through its strategic exploitation by competitors, thwarted competition. We also examine harms inflicted upon the institution of government regulation, arguing that misregulation, as under the current asymmetric regime, undermines legitimate regulation where government intervention supplies an efficient remedy for various market failures. Finally, we turn to the disabilities of the current regime in fostering timely movement toward a generally preferred environment characterized by vigorous market competition and minimal government regulation. Our view is that incentives under asymmetric regulation are incompatible with such a transition, and that, while not sufficient, reform that removes asymmetries in regulatory treatment of competing carriers is a necessary condition for making progress toward genuinely procompetitive deregulation.

Inapplicability of the Dominant-Firm Model to AT&T

AT&T's competitors claim/complain that AT&T is a dominant firm and must continue to meet the panoply of FCC dominant-carrier regulatory requirements. Before considering their minimal basis for proffering this claim, it is perhaps worth pointing out that, were AT&T truly a dominant firm and to behave authentically as such, that would cut very much in favor of its competitors' economic interests. In economic theory, a true dominant firm does not really compete with its rivals; instead it simply takes its rivals' outputs as a given in formulating its own supply decision.[1] Rivals are permitted to "do their worst," and the dominant firm then behaves as a pure price searcher, optimizing its output on the residual demand it perceives (viz., the demand it anticipates net of its' rivals' expected outputs at different prices).

This would obviously be a very favorable environment for the dominant firm's rivals. In the absence of effective regulation, the dominant firm is able to supply a "price umbrella" under which rivals can easily prosper, even if they are somewhat less efficient suppliers than the dominant firm. Rather than being a source of difficulties, competing with a truly dominant firm should be a picnic – price takers in perfectly competitive markets take a competitively-determined price as a given; price takers in a market in which there is a real dominant firm get to take a non-competitive price as a given that is a result of the dominant firm's output restriction. They are, by definition/market classification, afforded the opportunity freely to exploit a higher umbrella price.

The claims/complaints of AT&T's rivals thus ring more than a little hollow. They strongly suggest that, far from adopting the true dominant firm's "do-your-worst" modus operandi, AT&T cannot

---

[1] See, e.g., James P. Quirk, Intermediate Microeconomics (Science Research Associates, 1976), pp. 274-76 ("any price set by the dominant firm is taken by all other firms to be given, beyond their control. . . . The other firms in the industry are assumed to be so small individually that each ignores the effects of its actions on the price of the industry's output"); and Stephen T. Call and William L. Holahan, Microeconomics (Wadsworth, Inc., 1983), pp. 308-09 ("the dominant firm serves the market that remains after the competitors have adjusted their sales to the profit-maximizing levels").

afford such a strategy and that AT&T is not simply letting its rivals have their way and then fattening up on the leftovers. It is rather competing a lot more vigorously than its rivals prefer, and it is apparently expected to do even more so if it is afforded greater competitive freedom. Thus, the opposition of AT&T's rivals to even so modest a step as imposing symmetrical regulation on the market suggests that their motivation is grounded in discomfiture with more strenuous competition, not with monopolistic output restriction by a dominant firm from which they would presumptively benefit. They naturally prefer the current asymmetric regulatory regime which imposes higher costs on AT&T than on them and affords them a variety of competitive advantages denied to AT&T.

AT&T's rivals argue that it is a dominant firm because its sales account for a substantial share of market output.[2] Indeed, some of their pleadings read as if they think that dominant-firm status and a substantial market share are one and the same.[3] Of course, a substantial market share may in certain circumstances indicate that a firm possesses some market power and even that it might be appropriately classified as a dominant firm. It can indicate these conclusions either because a substantial market share is itself actually a cause of (i.e., somehow confers) market power in some circumstances or, more typically, because it occurs as a consequence of other basic factors of supply and demand which operate to confer market power.

---

[2] See, e.g., Further Comments of the Competitive Telecommunications Association (Comptel) in Opposition (pp. 10-11); Comments of the Independent Data Communications Manufacturers Association (IDCMA) (pp. 4-5); Comments of Oncor Communications, Inc. (pp. 1-2).

[3] Ibid. Oncor (p. 1) flatly states that, "By any standards, a company with a 60 percent market share . . . is a 'dominant' carrier."

The problem for interpretation is that substantial market shares can also occur for reasons other than monopoly power (e.g., the offer of good products and services at reasonable prices or uneconomic regulatory pricing which makes competition for certain customers unattractive) and, therefore, do not necessarily indicate market power. Thus, it is very difficult to draw correct inferences about market power directly from market share, whether conceived as cause or consequence, without reference to underlying factors affecting supply and demand.[4]

In addition to citing AT&T's market share, AT&T's rivals also claim that its ability to raise its own basic rates implies market power.[5] This is a non sequitur. Market power is the ability to restrict market output and raise market price above the competitive level. Leaving aside for the moment whether rate restructures by AT&T actually entail rate increases above competitive levels, AT&T's ability to alter its own prices carries no implication with

---

[4] This is especially so where, as in the instant case, the claim is that market share alone somehow causes market power. We note that AT&T's competitors offer no explanation of how AT&T's market share is able to confer market power given the conditions of supply and demand currently prevailing in the long-distance marketplace.

Moreover, we note that while simply observing relative differences in market shares among competitors at any given time (the "snapshot" technique) without taking into account relevant underlying factors, suggests little about a firm's dominance, observing and accounting for changes in market shares over time (the "motion picture" technique) can say a great deal more about the competitiveness of a given market. Thus, it is relevant to note the long-term secular decline in AT&T's market share and AT&T's strenuous (if only modestly successful) efforts to stem its share losses and "win back share" in recent years, both indicative to us of increasingly vigorous rivalry.

See IXC Rulemaking Order, 6 FCC Rcd., p. 5890 (market share does not indicate market power in markets with "high supply and demand elasticities," and a substantial market share "is not incompatible with a highly competitive market"). See also Commercial Services Streamlining Order, ¶ 19 ("[r]elying solely on AT&T's market share at a given point in time [to determine whether AT&T has market power] . . . would be too static and one-dimensional").

[5] See, e.g., IDCMA, pp. 7-8.

respect to its ability to raise market prices to noncompetitive levels. AT&T's rivals fail ever to address the only relevant question pertaining to AT&T's alleged dominance; indeed, they apparently would make a virtue of their failure and mock the efforts of others to adduce relevant evidence.[6]

Under the system of price-cap regulation that governs its pricing, AT&T is afforded a modicum of flexibility to reconfigure its rates for various types of services within the constraints imposed by the price cap plan and the general statutory proscriptions against unjust and unreasonable rates. As in many regulated industries, the regulatory pricing structure in the telecommunications industry did not, at the onset of competition, conform closely to an economically efficient configuration of rates, either in terms of rate levels or structure. Indeed, a very important – in our view, probably the single most important – factor driving the competitive revolution in telecommunications has been the economically inefficient pricing that occurred historically under regulation.

In general, introducing competition into regulated industries has had two salutary consequences for pricing: competition has compelled a rationalization of rates more consistent with the imperatives of economic efficiency, and, as regulatory pricing proscriptions have been relaxed, competition has engendered a much greater diversification of service offerings more closely matched to individual customer tastes and preferences.[7] One of the

---

[6] Consider IDCMA's characterizations (at pp. 3-4) of AT&T's submission as consisting of "academic theory" and "well-packaged speculation."

[7] See Richard E. Caves and Marc J. Roberts (eds.), Regulating the Product: Quality and Variety (Balinger: Cambridge, Mass., 1975) and, in particular, (continued...)

important losses from historical regulation of price and competition in telecommunications was a loss of product and service variety.

In recent years, AT&T has undertaken to rebalance its rates in conformance with the dictates of competition and economic efficiency. Notwithstanding the convenient myopia of its critics, AT&T has not simply raised its rates. It has raised some rates and lowered others within the constraints imposed by the government's pricing rules. The effect of its rebalancing has been, broadly speaking and in relative terms, to raise charges modestly for the lightest users and to lower them for heavier (although by no means exclusively the heaviest) users.[8] Thus, just as one can (and for similar reasons) expect to pay relatively more per ounce of corn flakes purchasing a small package compared to a large one, one might expect to pay more per minute of long-distance calling the fewer the volume of calls one makes.

Contrary to the allegations of critics, this kind of rebalancing is not unreasonable price discrimination; indeed it is not price discrimination at all. It is rather the antithesis of price discrimination, representing an attempt to restructure rates so that fixed-cost burdens of serving individual customers (viz., e.g., packaging/billing) are properly assigned. In the absence of price variations, light users below the break-even volume would pay rates that fail to recover the associated fixed-costs burden,

---

7 (...continued) Lawrence J. White's "Quality, Competition and Regulation: Evidence from the Airline Industry."

8 Users with as little as $10-per-month's worth of traffic qualify for some AT&T discounts. In today's market, the so-called "high end" is, in truth, not very high, and the "low end" is not very large in terms of the relative volume of calling.

leaving a higher burden to be recovered elsewhere (a problematic prospect given competition) or taken as a loss on a continuing basis (also obviously problematical).

Note too that, far from manifesting market power, this type of rebalancing is compelled by effective competition. Were AT&T to fail to institute such rebalancing, it would lose higher-volume customers to its competition. Thus, the rate restructuring we observe in the long-distance business is itself a symptom and clear manifestation of effective competition. Consider that AT&T's failure to undertake a restructuring of rates to conform them with the imperatives of economic efficiency or, alternatively, AT&T's ability to sustain losses on a continuing basis on low-volume customers in the absence of rate rationalization would indicate a lack of effective competition. As Economic Nobelist Gary Becker has remarked, effective competition makes discrimination impossible.[9] Effective competition in the long-distance business is thus rapidly rendering historical modes of price discrimination infeasible.

Meanwhile, AT&T's critics cite AT&T's rivals' willingness to follow AT&T's lead in raising prices at the low end as evidence of AT&T's price leadership and dominance.[10] Because basic rates have been held below costs for light users, it is hardly necessary to

---

[9] See The Economics of Discrimination (The Univ. of Chicago Press, 1971).

[10] See Further Opposition of Bell Atlantic Corporation, BellSouth Corporation, Pacific Telesis Group, and SBC Communications Inc., p. 8. These carriers cite OPP Working Paper No. 25 in support of their contention that AT&T acts as the dominant price leader. That paper, in fact, argues that the dominant-firm model of economics is not applicable to the long-distance market and that AT&T cannot be properly characterized as a dominant firm. See John Haring and Kathy Levitz, What Makes the Dominant Firm Dominant?, OPP Working Paper Series, No. 25, April 1989.

deploy such heavy weaponry to explain AT&T's desire to raise such rates when afforded the opportunity to do so under price caps. Nor does it take rocket science to comprehend the willingness of AT&T's rivals to follow suit -- failure to do so increases the likelihood of their attracting unprofitable customers.

Recourse to heavy weaponry to explain behavioral patterns in this sector of the market, where the rewards of alleged collusion are mitigation of losses, carries with it a consistency requirement that raises a dilemma for critics so disposed: Why are the carriers not able to deploy such allegedly serviceable means to raise prices for high-end users? If higher prices are simply a matter of follow-the-leader, why only play the game where the rewards are small? Indeed, why not agree not to offer any discounts at all?

The critical conjecture about the strategic interaction of competitors in the dominant-firm model of economics is the willingness of the dominant firm simply to allow rivals to sell all they wish and then compensate for their sales in its own supply decisions. The dominant-firm model supplies a reasonable characterization of actual circumstances as long as the putatively dominant firm's competitive rivals do not count for much. But as the capacity of competitive suppliers rises relative to the size of the market (and the incumbent), these firms can no longer reasonably take the dominant firm's price as a given, and the dominant firm can no longer afford to allow rival firms to sell all that they wish at the price it selects. Consider the implications of rival firms' ability to supply the whole market for the plausibility of the dominant-firm model's version of events![11]

In economic terms, the issue of market dominance turns not on market shares based on historical measures of sales, but on the comparative size of competitors' supply capabilities. Backward-looking share measures do not supply an answer to the one critical question relevant to the issue of dominance: How much power does a firm possess to restrict market output below the competitive level? The larger the supply capabilities of a firm's rivals, the smaller the firm's own ability to restrict market output. What matters are forward-looking estimates of plausible supply responses over different time frames. Market share merely supplies a mark against which rivals' supply capabilities may be gauged. The relevant question here is whether AT&T's competitors possess sufficient capacity to render an AT&T price increase unprofitable. This they clearly do.

In CC Docket No. 90-132, AT&T submitted a Bell Labs study demonstrating that within an 18-month period MCI and Sprint could absorb 100 percent of AT&T's switched services and that the National Telecommunications Network (NTN) consortium could absorb 82 percent of AT&T's private line services.[12] This evidence led the Commission to conclude in that proceeding that "AT&T competitors

---

[11] Haring and Levitz, op. cit., p. 8, note that, "[I]f the only thing that prevents firm B (or C or D) from taking business from firm A is its (or their) willingness to quote a sufficiently low price, there is no economically relevant sense in which firm A can be said to be 'dominant'," and that "[W]hen no firm can be uniquely categorized as dominant, no asymmetric assignment of regulatory liabilities can be legitimately defended."

[12] See V.A. Blake, P.V. Flynn and F.B. Jennings, "A Study of AT&T's Competitors' Capacity to Absorb Rapid Demand Growth," AT&T Bell Laboratories, June 20, 1990.

have enough readily available supply capacity to constrain AT&T's market behavior and inhibit it from charging excessive rates."[13]

In the current proceeding, AT&T has submitted an update to this earlier study demonstrating that AT&T's competitors have retained the ability to absorb a significant percentage of traffic from AT&T customers.[14] The study documents that AT&T's competitors

> . . . can instantaneously absorb a minimum of 15 % of AT&T's total 1993 switched minutes on their existing networks without incurring any incremental capital costs. An additional 17 % of AT&T's total 1993 switched minutes could be absorbed by AT&T's competitors within 3 months utilizing spare switch ports and existing transport facilities. Within one year, AT&T's competitors could absorb 63 % of AT&T's total switched minutes by adding switch ports, echo cancelers, and digital cross connect equipment. All of AT&T's switched minutes could be absorbed by AT&T's competitors within 18 months by adding switch ports and lighting dark fiber with the latest electronics, the principal limiting factor being the rate at which they could obtain additional switch ports from their switch suppliers.[15]

The idea that AT&T has the unilateral power to establish market prices for long-distance services while confronting a set of competitive rivals possessing a joint supply capability of this magnitude simply cannot be sustained.[16] The modern economic view

---

[13] FCC, In the Matter of Competition in the Interstate Interexchange Market, Report and Order, CC Docket No. 90-132, Sept. 16, 1991, ¶47.

[14] See T.L. Brand, et al., "An Updated Study of AT&T's Competitors' Capacity to Absorb Rapid Demand Growth," AT&T Bell Laboratories, April 19, 1995.

[15] Ibid., p. 2.

[16] The idea that MCI and Sprint can be plausibly viewed as part of a "competitive fringe" as that rubric is defined in the context of the dominant-firm model is facially ludicrous. "Fringe" is clearly a misnomer when applied in this context. See Haring and Levitz, op. cit., p. 11.

is that market power depends primarily on conditions governing the timely and effective expansion of supply in a market, not on market share. In the U.S. long-distance market, AT&T clearly does not possess the power to restrain market output and should, therefore, no longer be classified as dominant for purposes of assigning asymmetric regulatory burdens.

In today's market, customers have numerous carriers from which to choose and demonstrate a marked propensity to switch carriers in pursuit of a better deal. In 1994, customers switched carriers 27 million times, and it is estimated that about one in five households altered their supply arrangements.[17] If competitors possess the ability to counter any supply restriction by AT&T and customers are able and apparently quite willing to switch carriers, it is difficult to fathom how AT&T could profitably restrain the supply of services in the marketplace.

It is long past time when all long-distance carriers should be playing by the same set of rules. Today, the plain truth is that AT&T's market shares in different market segments primarily reflect its effectiveness as a competitor matched against an elastic set of formidable rivals and the historical legacy of prices set below relevant costs for the lightest users. To pretend that AT&T's market share somehow signifies its ability to restrain trade and earn monopoly profits in today's long-distance market is simply foolish. Indeed, to cite the Justice Department's merger guide-

---

[17] See Ex Parte Presentation by AT&T to the FCC, CC Docket 79-252, February 8, 1995, and in particular, the chart labeled, "Competition — Customers' Freedom of Choice."

lines as somehow supportive of continued asymmetric regulation of AT&T, as IDCMA has done,[18] is only a mark of ignorance.

Harms to Competitive and Governmental Processes

It would be one thing if regulation were simply superfluous, irrelevant to the extent that competitive forces effectively policed the market. In that case, the need for reform would not be a pressing concern and would be more a matter of tying up loose ends. The problem is that the FCC's regulation of the long-distance market is not simply superfluous; its existence has consequences because it affects the behavior of competing firms and, because under the current regime it is asymmetrically imposed, it affects them differently. These impacts of regulation affect both the incentives of market participants and competition in the marketplace.

The FCC's current asymmetric regulatory regime in long-distance subjects AT&T to a number of constraints and burdens that are not imposed upon its rivals. Unlike its competitors, whose tariffs may be filed on short notice and are presumed lawful, AT&T generally has to file its tariffs well in advance of their effective date, and many of its tariffs are not presumptively lawful. The requirement to disclose its competitive offerings substantially in advance of their effective date puts AT&T at a significant competitive disadvantage since, as a consequence, its competitors get advance notice of its competitive plans and the opportunity to react in advance, indeed, the ability to beat AT&T

---

18 See IDCMA, p. 5 and p. 6.

to the punch and steal its thunder. Since its ability to gain competitive advantage is thereby weakened, AT&T's incentive to seek such advantage is also thereby weakened to the obvious detriment of competition and consumer welfare.

A recent example supplies a depressing illustration of how the Commission's current regulatory regime stifles competition. Earlier this year AT&T sought to respond to new discount pricing plans introduced by its rivals (on one day's notice!). AT&T had to give 45 days' notice and its offering was not presumptively lawful. On the 15th day of the notice cycle, MCI intervened and challenged AT&T's offering on the grounds that AT&T's proposed prices were *too low*. AT&T's offering was delayed for more than a month and, in the interim, MCI filed a matching tariff on one day's notice. AT&T's offering apparently could have saved consumers something on the order of $1 million per day.

A similar example illustrating how the Commission's asymmetric regime can be exploited for competitive advantage and to discourage competitive initiative involved AT&T's "Free Weekend" promotion. Again MCI intervened and challenged AT&T's offering, again the effective date was delayed, and again MCI was permitted to file a matching offer on one day's notice, allowing MCI to counter AT&T's promotion within 24 hours.

These instances in which the FCC's asymmetric filing requirements operate to frustrate competition not only cost consumers money as a consequence of delays in the availability of discounts and promotions, but they also harm consumers by reducing AT&T's incentives to be creative and to seek competitive advantage through innovative marketing efforts. Instead of protecting consumers, the actual effect of the asymmetric tariffing process is to harm them by affording AT&T's competitors an easy source of competitively sensitive intelligence and a not-very-demanding means of delaying and deflecting their rival's competitive initiatives. The current regime is not protecting competition; it is protecting competitors _from_ competition by AT&T. It is impossible to know the full extent of the resulting competitive and consumer loss since, under such an asymmetric regime, AT&T has an incentive to pull its punches. One cannot measure the foregone benefits of an offering that has not been made due to suppression of competitive incentive resulting from rivals' ability to exploit the regulatory process.

Asymmetric tariff filing requirements are the tip of the proverbial iceberg in terms of the differential burdens AT&T bears because of its misclassification as a dominant carrier. The price-cap plan under which AT&T operates significantly constrains AT&T's pricing freedom, and there are numerous other examples of disparate regulatory treatment. AT&T's competitors are permitted to run consumer promotions offering multiyear discounts. Under the FCC guidelines for promotions, however, AT&T is supposed to limit its consumer promotions to one year, and its promotions for services that have been streamlined to two years. In 1993, MCI ran a promotion offering ASDS customers a discount for a five-year period. AT&T sought to respond, but the FCC only permitted a two-year promotional discount for this previously streamlined business service. For Basket 1 service rate increases, AT&T is required to run an advertisement in every major newspaper in the country within two days of the effective date. Its competitors are subject to no similar requirement.

In 1994, AT&T filed a transmittal to prevent 800 number warehousing and provide for immediate disconnect for fraud. After a 112-day delay, the warehousing issue was resolved, but AT&T still remains differentially burdened on the tariff protection issue. AT&T must provide ten days' written notification before disconnecting a customer, while its competitors can disconnect problem customers without notice. AT&T was required to delete language from its tariff (dealing with instances in which a customer owes $1,000 or more in undisputed charges) that was drawn directly from tariffs its competitors already had in effect. This differential treatment places AT&T at a greater risk of financial liability and provides AT&T with less ability to control its own costs than its competitors.

In 1994, AT&T filed a transmittal to collect deposits sufficient to provide protection against resellers who sign up to capitalize on promotions available under term plans and then default on their contractual commitments. When the tariff was finally approved after a significant delay (prompted by the intervention of resellers wishing to avoid making deposits), AT&T was afforded virtually no discretion in administering such deposits. In contrast, its competitors' tariff provisions concerning deposits afford them considerable discretion. As a result, AT&T's rivals can protect themselves against perceivedly risky business, while AT&T is required to assume credit risks its rivals can avoid or insure against.

While the FCC's resale policies are, in principle, supposed to apply equally to all carriers, MCI has filed A-B tariffs for provision of VNET service (comparable to AT&T's SDN service) which provide a means of discriminating between those resellers perceived as bad risks and other customers. These tariffs provide for one set of rates to customer affiliates and another set of higher rates for non-affiliate customer locations (viz., a reseller's end user). AT&T's requests for similar tariffs were turned down by the FCC and, as noted above, it is subject to a strict set of constraints in terms of deposits. Timely payment by resellers has apparently been a significant problem. AT&T information indicates that resellers take more than twice as long to pay and have substantially higher default rates than the average commercial customer.

In addition to these and other examples of disparate regulatory burdens which directly affect results in the marketplace, AT&T is subject to a variety of accounting requirements which serve no apparent public purpose and involve significant cost burdens. AT&T is the only IXC required to maintain separated (state/interstate) books and records in accordance with the Uniform System of Accounts (USOA). AT&T's competitors maintain their books in accordance with Generally Accepted Accounting Principles (GAAP), just as AT&T does for its nonregulated books. In addition, AT&T has substantial FCC-imposed reporting requirements to which its competitors are not subjected. For example, the Interstate Rate of Return report, the quarterly Cost and Revenue report, and the Consolidated Annual report (Form M) are required only of AT&T. The administrative cost to AT&T of maintaining a separate set of regulated books and records, in addition to the unique reporting requirements placed on AT&T, has historically amounted to over $40 million per year.

These requirements serve no purpose under price-cap regulation and their elimination would certainly be consistent with the Administration's Reinventing Government initiative.[19]

In addition to the economic harms from unwarranted and inefficient regulations, there is another adverse consequence of delay in regulatory reform, a cost that assumes special significance in today's political environment. When regulations are extended beyond the time they are needed or serve a useful economic purpose, respect and support for the institution of regulation is undermined. Just as bad laws and capricious enforcement of the law breed contempt for the law, bad regulation undermines support for the regulatory enterprise.

The FCC's current asymmetric regulatory regime in long-distance not only inhibits the free play of competitive market forces and thus harms the competitive process and consumers, but also undermines public respect and support for the regulatory process itself. The pursuit of outmoded or counterproductive or wasteful policies, all of which describe the FCC's asymmetric regulation of AT&T, undermines public support for pursuit of legitimate regulatory enterprises. This produces a variant of Gresham's Law in which bad regulation drives out good regulation. Bad regulation thus subverts good governance and, in this manner, harms the people not only in their role as consumers of long-distance telephone services, but as citizens who expect well-conceived regulation to control genuine abuses of power, ensure

---

[19] Similarly, the FCC's imposition of cost allocation rules on AT&T does not make sense in today's competitive environment where the process of cost allocation, Cost Allocation Manual filings, and annual audits produces no benefit, but imposes substantial compliance costs.

adequate provision of public goods, and perform other legitimate and economically desirable functions of the state.

Transition to a Deregulated Long-Distance Marketplace

Under the Communications Act, the FCC is precluded from forbearing completely from regulation of the long-distance market. Despite this constraint, the Commission may, however, significantly streamline its regulation.

The FCC has, in fact, made several important and commendable changes in its regulation of the long-distance market through the years, although some perspective on these reforms is perhaps in order. First, it should be recognized that the two conditions that the U.S. Department of Justice and District Court Judge Harold Greene deemed necessary to prevent AT&T from exercising market power and that were embodied in the MFJ were accomplished at and soon after divestiture (i.e., ten years ago). AT&T was divested of the Bell Operating Companies (BOCs) and, as a consequence, was no longer in a position to provide discriminatory interconnection to competitors or to subsidize the prices of its interexchange services with revenue from local exchange services or to shift costs from competitive interexchange services to local exchange services. And the BOCs began offering equal access to all long-distance companies as required under the terms of the MFJ. As Judge Greene noted at the time, "[W]ith the removal of these barriers to com-